April 3, 2003

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Supervisors:

OVS AGREEMENT - SUPPLEMENTAL INFORMATION RELATING TO THE BUSINESS LICENSE COMMISSION RECOMMENDATIONS

(FIFTH DISTRICT)

Background

On March 5, 2003, the Business License Commission ("BLC") voted to recommend the approval of an Open Video System ("OVS") Agreement between the County and Altrio Communications, Inc. ("Altrio").

In addition to this recommendation, the BLC requested that your Board:

1) Review and consider, in conjunction with the approval of the OVS Agreement, the financial qualifications of Altrio to construct, operate and maintain the OVS.

2) Review and consider, in conjunction with the approval of the OVS Agreement, whether to require, as a condition of approving the OVS Agreement, that a provision be added to the Agreement requiring that Altrio, as the owner of the construction project (for the OVS), secure a payment bond.

On March 6, 2003, the Department of Consumer Affairs ("Consumer Affairs") sent a report to your Board providing you with an overview of the services that are being offered in the proposed OVS Agreement, and presenting the opportunity for cable television competition in the Designated Service Areas. As indicated in that report, the proposed OVS Agreement with Altrio represents the first time that a company has applied to build a system to provide video (cable television) service in direct competition with an incumbent cable system serving unincorporated Los Angeles County.

Purpose of Supplemental Report

Consumer Affairs is providing this supplemental information regarding the issues of Altrio's financial qualifications and bonding requirements in order to provide your Board with additional information to review and consider the issues raised in the Business License Commission's recommendation.

We believe that it is important for you to have this information prior to deciding whether to approve the OVS Agreement. After your Board approves the OVS Agreement, the County will be limited in its ability to impose further conditions in the OVS Agreement or make a determination about Altrio's financial qualifications. Additionally, we will explain our rationale for recommending the approval of the OVS Agreement between the County and Altrio.

Financial Qualifications

Altrio incorporated in the State of California in August 2000. Their business plan focuses on the construction of their state-of-the-art OVS system in Los Angeles County's San Gabriel Valley areas and adjoining communities. Altrio's investors who collectively committed over $100 million to their initial phase of their business plan include: Frontenac Company, Bessemer Holdings, Soros Private Equity Partners, SSB Capital Partners (the private equity investment fund of Salomon Smith Barney), Royal Bank Capital Partners-Telecom Fund, and Grove Street Advisors (whose largest limited partner is CalPERS). Altrio is headquartered in Los Angeles and their Board of Directors includes former Los Angeles City Mayor and businessman, Richard Riordan.

In determining whether to approve the OVS Agreement between the County and Altrio, the County has the right to consider the legal, technical and financial qualifications of the OVS operator to construct, operate and maintain the OVS. As part of our review of Altrio's financial qualifications, the Department of Consumer Affairs requested that the Department of Auditor-Controller ("Auditor-Controller") review Altrio's financial statements and issue their opinion whether Altrio has the financial qualifications to construct, operate and maintain the portion of the OVS system proposed in the OVS Agreement.

Initially, the Department of Auditor-Controller reviewed Altrio's audited financial statements for the year ended December 31, 2000 and the unaudited statements for the period ended November 30, 2001. In 2002, they issued a memorandum dated March 5th stating that Altrio is a development stage company and that a traditional financial statement review is not appropriate since Altrio had not yet generated any income. They recommended that if Consumer Affairs were to recommend approval of the OVS

Agreement, that we should require Altrio to provide a performance bond and continue to monitor their financial condition.

The Business License Commission at their February 19, 2003 hearing requested that Consumer Affairs obtain more current financial data from Altrio. Consumer Affairs requested Altrio to provide the most current financial data available and were informed by Altrio that their calendar year 2002 financial statements were in the process of being audited and that they did not know when the audit findings would be available. Nonetheless, Altrio did provide their audited financial statements for the year ended December 31, 2001 and unaudited statements for January 1 - November 30, 2002.

The Auditor-Controller then reviewed these statements and issued another letter dated March 4, 2003, which stated that Altrio reported net losses in the two periods reviewed and therefore their ratio analysis of Altrio shows their condition as weak. The Auditor-Controller also stated that these losses might be expected in a start-up company, but that they do not have any reliable recent data on Altrio's financial condition.

This information was provided to the Business License Commission at their March 5, 2003 hearing. The Commission raised concerns over the Auditor-Controller's letter and characterization of Altrio's financial condition as "weak". Therefore as part of the Commission's recommendation, they requested that your Board consider Altrio's financial qualifications.

In an attempt to gather all available data for your Board's consideration, Consumer Affairs again requested assistance from the Auditor-Controller. We asked the Auditor-Controller to meet with Altrio to further evaluate Altrio's financial qualifications. In their April 1, 2003 letter (attached), the Auditor-Controller states, "While Altrio's audited financials for the year ended December 31, 2001 indicated that the Company appeared to have adequate committed capital for the proposed Agreement with the County, it is unclear how much of that capital is still available." They also stated that Altrio did provide them with projections showing they will become profitable, but there is no assurance that Altrio will achieve these objectives.

In summary, however, the Auditor-Controller acknowledged that Altrio's lack of documentation and weak financial condition may not be unusual for a development phase company and therefore may not be an indicator of Altrio's ability to perform under the proposed Agreement with the County. They again recommended that Consumer Affairs continue to monitor Altrio's financial condition and require Altrio to secure a performance bond to protect the County in the event that Altrio defaults.

Bonding Requirements

The proposed OVS Agreement between the County and Altrio relates to the construction and operation of an OVS owned by Altrio, not the County. Altrio would be using the County rights-of-way for the operation and construction of the open video system, and the County has authority to impose reasonable terms and conditions related to the use of its rights-of-way. The bonding requirements that we have negotiated reflect this relationship between the County and Altrio.

<u>Payment Bonds</u>

Payment bonds are neither required by this Agreement nor any other County franchise agreement currently in place. The purpose of payment bonds is to ensure that contractors and employees are guaranteed payment for work contracted by Altrio. If contractors or employees are not paid according to agreements entered into with Altrio or their general contractor, they may file a mechanics lien against Altrio's assets. The County would not be liable for these claims nor could such liens be placed against the County. Payment bonds would actually protect Altrio in case they hired a contractor who failed to pay their employees or subcontractors.

While payment bonds are a requirement in situations where the County contracts with a contractor to build a County owned facility, this is not the circumstance here. This is a private construction project owned by Altrio.

If the Board wishes to consider imposing a payment bond in this Agreement, further exploration of the implications in the areas of liability, enforcement costs and impact on other private companies using the County rights-of-way, should be addressed.

<u>Performance Bonds</u>

Performance bonds are a standard provision in agreements to construct, operate and maintain cable television systems. The purpose of requesting bonding or other types of security, such as a Letter of Credit, is to protect the County should the cable provider default. The Departments of Public Works ("Public Works"), Consumer Affairs, and County Counsel have determined that the County is sufficiently protected by imposing a performance bond, liability insurance and Letter of Credit in the proposed OVS Agreement.

Public Works and Consumer Affairs have determined that a performance bond in the amount of $150,000 is sufficient to cover the County's costs for repairing any road work to a satisfactory condition, such as using the bond to pay for closing an open trench in a public street. The performance bond is not meant to cover the County's costs to complete construction of Altrio's open video system. The County's consultant on cable television franchise issues advises us that based on his 22 years experience in the industry, this is the industry standard.

Additional protection is afforded by Public Works procedure whereby they only issue a limited number of permits at one time. Therefore, the amount of work Altrio could perform on the public rights-of-way at any one time is limited. The performance bond amount is sufficient to cover the County's potential exposure of repairing road work if Altrio were to walk away from the project during construction.

Recommendation

Consumer Affairs recommends that the Board approve and adopt the OVS Agreement between the County and Altrio while taking into consideration the Auditor-Controller's most recent evaluations of Altrio's financial condition. Our recommendation is based upon the overall benefits that Altrio's proposed OVS will have for the County and the residents in the Designated Service Areas. We believe that it is important to bring choice to consumers and foster competition in the marketplace. Further, we do not believe that a payment bond should be required in this OVS Agreement. If Altrio defaults on their obligations to the County, a performance bond and Letter of Credit, which are provisions of the proposed Agreement, provide the County with sufficient protection.

Respectfully Submitted,

Pastor Herrera, Jr.
Director

Attachment: Auditor-Controller's April 2, 2003 letter

c: Altrio Communications
Chief Administrative Officer
Executive Officer, Board of Supervisors
Department of Auditor-Controller
Office of the County Counsel
Department of Public Works
Internal Services Department

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COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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J. TYLER McCAULEY
AUDITOR-CONTROLLER

April 2, 2003

TO: Pastor Herrera, Jr., Director
Department of Consumer Affairs

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **FINANCIAL CONDITION OF ALTRIO COMMUNICATIONS, INC.**

At your request, we met with Altrio Communications, Inc.'s (Altrio) management. Our March 18, 2003 meeting was intended to further evaluate Altrio's financial qualifications to complete and operate the proposed open video system (OVS).

As indicated in our March 4, 2003 memo, Altrio is a development phase company and has reported net losses for the periods ending December 31, 2001 and November 30, 2002. Based on the losses, our ratio analysis shows Altrio's financial condition is weak. While Altrio's audited financial statements for the year ended December 31, 2001 indicated that the Company appeared to have adequate committed capital for the proposed agreement with the County, it is unclear how much of that capital is still available.

We attempted to obtain updated information on Altrio's available capital. However, we were unable to obtain updated information. The Company's financial statements for the year ended December 31, 2002 are currently being audited by Deloitte & Touche who declined to comment on Altrio's financial condition until its audit is completed.

During our recent meeting with Altrio, they provided us with projections for the Company's future financial performance. While these projections show Altrio will become profitable, as with any projection, there is no assurance that these projections will be achieved.

The lack of documentation and a weak financial condition may not be unusual for a development phase company and therefore may not be an indicator of Altrio's ability to perform under the proposed agreement with the County. However, it does indicate uncertainty with the Company's financial condition. For that reason, in our March 4th memo, we recommended that, if the Board approves Altrio's application to construct and operate an OVS, Department of Consumer Affairs (DCA) should monitor Altrio's financial condition on an ongoing basis.

In our March 4th memo, we also recommended that the proposed agreement require Altrio to secure a performance bond to protect the County in the event the company defaults, including sufficient protection to cover the County's costs to repair the road right-of-way if Altrio does not complete any portion of its construction. DCA Cable Franchising Division management has advised us that the proposed agreement with Altrio includes this protection by requiring Altrio to secure a performance bond in the amount of $150,000 and a Letter of Credit in the amount of $25,000.

Please call me at (213) 974-8301 if you have any questions or have your staff call Elaine Boyd at (626) 293-1114.

JTM:JS:EB

c: Steve Ross, Senior Vice President and General Counsel, Altrio Communications, Inc.